Investment Journey & Philosophy

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Disclaimer:

Views strictly personal and do not represent the views of the organizations I have worked/am working for. The points made here are inferences based on personal experiences, please do your due diligence before applying these to your unique investment scenario. I am not a SEBI registered Investment Advisor and none of this constitutes investment advice

Investment Journey

Unconscious Incompetence (2003-2008)

- Investments – FD and Savings account
- Reading – Next to nothing other than the typical MBA coursework and BS

Conscious Incompetence (2008-2011)

- Sheer laziness in opening a trading account saved me from the 2008 crash
- Phone banker mocked me in 2010 saying I was the ideal customer who had all his money lying in savings account
- Started investing in mutual funds while doing some nonsense in direct equity
- Notable Duds where I lost 80% of capital – Bartronics, MIC Electronics, Alok Industries, Punj Lloyd

My Lucky Breaks (2011-2013)

- Moved to the investment management industry in mid 2011
- Caught Cera Sanitary, Kajaria Ceramics and Amara Raja Batteries in early 2011
- Since results were good, starting probing why an idiot like me was able to make money – figured out I was lucky to have caught the building materials segment
- Other notable discoveries – Somany Ceramics, Dhanuka Agritech
- Still continued to make mistakes – Edserv, Shipping Corporation of India (naively believed PE was synonymous with valuation)
- Started doing a lot of reading – Graham, Soros, Phil Fisher
- Came up to speed on fixed income, FX and other macro fundas which helped me understand the overall investment context
- Tough years professionally, built a lot of patience and mental fortitude during this period

Investment Journey

Time to up the ante (2013- early 2014)

- Realized something was working, was determined to get better at this
- Positive reinforcement – picked Sanghvi Movers, Mayur Uni, Greenply which saw sharp re rating in early 2014
- Still was not happy on a professional note – was determined to excel at something, this was a huge factor in the next phase
- Reading – More stock specific than macro gyan, started building a focus on how to analyse businesses

Brutal hard work (mid 2014 till date)

- Process, checklist and formal equity research notes
- Second guessing myself and an objective view to all my success stories, realistic view of my abilities, started articulating my hypothesis
- Success stories – APL Apollo, Garware Wall Ropes, LG Balakrishnan
- Other picks yet to be proven – TCPL Packaging, Finolex Cables, Linc Pens
- Reading – Across genres, influenced by Michael Mauboussin, Nassim Taleb, Scott Adams
- Active focus on behavioural aspects – Basic behavioural finance reading, seek out sources like Zerohedge which focus on negative views
- Multi disciplinary thinking – on my way to becoming a perpetual learning machine
- Current focus areas – F&O, Deep dive into accounting & Corporate Governance
- Built a small group of equally focused people to run ideas by and seek feedback, joined Valuepickr in 2016

Investment Philosophy

- Be in the market to create wealth, not to make money. Big difference in approaches

- Invest with a 3-5 year view into stories that have the potential to offer asymmetric payoff ratios, usually have a gating criteria of 2X in 3 years or 3X+ in 5 years in terms of return expectations

- Have consciously looked to avoid boxing myself into a particular style though there are similarities across all my stock picks other than Sanghvi Movers

- Firm believer in the principles of reduction and negative lists than in having specific areas of competence

- What have I avoided so far
  - Segments where Govt regulation and interference can be a problem
  - Industries where risk of rapid technology obsolescence is realistic
  - Businesses where human capital is very important
  - Businesses heavy on intangible assets
  - Sectors which hire too many IIT and IIM graduates
  - Professional managers who rise up the ladder through politics and encourage bureaucracy

- What have I preferred so far
  - Brick and Mortar businesses which are easy to analyse and understand
  - Entrepreneur owned and entrepreneur run companies (first & second generation)
  - Industries and Segments which ET does not write about

What patterns have worked so far

- Keep things simple, never try to be the first person to discover a story. Let markets discover potential stories and build them up to a market cap of 300 Cr and beyond. Keep watching stocks in the 300 Cr to 700 Cr market cap range with strong price and earnings momentum over the past 18-24 months

- Apply all negative lists and focus on businesses that make the first cut, only then deep dive into detailed research. As of today I can eliminate most ideas within the first 30 mins with a cursory analysis. After sleeping over the handful of ideas for over a week if I am still excited by something the idea usually has some bite

- Have avoided overpaying for businesses (notable exception being AIA Engineering which I have exited). Need to see a tangible difference between what is being priced in and what is probabilistically possible over the medium term – my definition of margin of safety. My opinion is that quality by itself does not make a good investment

- Evaluate managements based on what they have done, not based on what they say. Have never felt the need to do management Q&A other than listening to conference calls, I acknowledge my limitations in this area and work with this in mind. Hence invest in stocks which have been listed for at least 10 years, taking a storyline approach usually reveals enough about how management runs this business

What patterns have worked so far

- Am very comfortable investing in stories where I may not have all the answers but am able to recognize favourable possibilities. I average up as the possibilities start fructifying till I stop seeing any margin of safety, usually take 12-18 months to build my position in a stock - 80%+ strike rate over the past 5 years (of course all trends work brilliantly till they stop working one fine day)

- Prefer stories where the crux of my investment hypothesis is never visible with a superficial analysis. Like stories where a multiple number of positive developments are happening simultaneously and favourable possibilities can create a large delta (classic examples being APL Apollo Tubes & Garware Wall Ropes)

- Have been a sophisticated and value conscious trend follower who takes the lazy approach of letting the market do the work of discovering a stock and then jumps in to ride out the next phases of business growth. Limitation of this approach is that 10X+ stories won't materialize but the strike rate of discovering 4X+ stories can be reasonably high. Approach also driven by the fact that my business analysis skills were not up to the mark till 2016

Personality Traits

- Naturally gifted at **capital allocation.** Got this aspect right intuitively from 2011 onward (of course this can harm during a negative cycle)

- Firm believer in a **concentrated portfolio**, take large infrequent bets (max 2-3 a year) backed by hard work, self belief and a probabilistic mind set (reverse DCF)

- Hate making errors of commission, am fine with letting opportunities pass by

- Tendency to **second guess myself** and critically evaluate every move I make – works well in investing but can be troublesome in other aspects of life

- **Preference for extremes over averages**, naturally prone to putting too much skin in the game (can be killer in a negative cycle)

- Am **self aware** and can **self regulate** to a respectable extent, do not get emotionally hung up over stocks or even people for that matter

- **Calculated risk taker** (evidence in career moves as well), aware that mistakes are inevitable though I hate making mistakes!

- Have gotten better at **abstracting learnings from different aspects and applying them to different contexts**

- Have been a lazy bum for the first 30 years of my life, my interest in investing originates from the lazy man's dream of maximizing the return to effort ratio

What I like to see in Businesses

Top 3 player (Sales, installed capacity, capital efficiency) operating in industries with a consolidated structure or a long tail of unorganized players. Minimal entry rate of new players over the past 10 years

Addressable market size large enough for the business to grow earnings at least 15% (ideally 20%+) over the next 5 years

Relative advantages over competition (scale, product portfolio, capital structure, brand & associations, distribution). Special attention where you have one player in a different league compared to competition (APL Apollo Tubes, Garware Wall Ropes, LG Balakrishnan)

Healthy ROCE and ROE profiles (am fine with 16% as long as other factors compensate)

Undervaluation in my opinion (not necessarily in a conventional way), over valuation is a strict no though

No equity dilution or accelerated debt raising, healthy dividend payout is a plus though not mandatory

Need to be able to identify multiple small things that can work in unison to deliver asymmetrical payoffs, like ideas which cannot be slotted into a simple template

Strong preference for businesses where the range of outcomes is not wide

Ignorables/ Non Ignorables

Can Ignore

- High Promoter Salary (highest in any of my investments has been 10% of PAT)
- Management that is not very presentable (Mayur Uni, LG Balakrishnan)
- ROE lower than 15% during bad years
- Negative FCF provided high reinvestment rates are justified by the market opportunity
- D/E of up to 1.25 as long as management has demonstrated financial discipline over a long period of time
- Relative undervaluation to peers (will never be a big factor for me by itself)

Cannot Ignore

- Repeated instances of management biting off more than they can chew (inordinate expansion when things are going well)
- Corporate action that is inconsistent with common sense (Talwalkars buying a chain in Sri Lanka)
- Any player pursuing a strategy drastically different from competition (Tree House)
- Promoter pledging
- Accelerated debt raising (Shilpi Cables, Hanung Toys)
- Frequent equity dilution
- Any management that indicates aspiration to become a conglomerate
- Sudden spike in auditor remuneration

Frameworks I use

- **Moat Analysis** – Morningstar Framework (Intangible Assets, Switching Costs, Network Effect, Cost Advantage)

- **Industry Analysis** – Michael Porter's five forces (in addition to Industry growth rate, ROCE, Structure)

- **Pro actively identify risks that scare me the most**
  - Risk of rapid technology obsolescence
  - Risk of Government intervention/regulations
  - If I were a promoter with malefic intent, how easy is it to siphon off cash and identify those sources. Obsessively look for these indications
  - Demand from Capacity utilization driven or capacity creation
  - Intermediate products to concentrated buying centres?
  - Commodity risk/pricing risk

- **Timing Evaluation**
  - Price momentum over the past 12 months – Strong/Stagnant/Weak
  - Quality of the Business – Wide Moat/Narrow Moat
  - Valuation – Expensive/Fair/Cheap
  - Re Rating Stage – Early/Underway/Over
  - Earnings Momentum (24 months) – Strong/Steady/Slowing/Weak

Approach to Buying & Selling

Buying

Averaging up suits my current style since I am investing based on possibilities

Price anchoring has not affected my buying (business may be cheaper today though stock price is higher)

Unless valuation screams a clear buy, prefer to buy over a period of 12-18 months

Always buy with a reverse DCF mindset

Depending on conviction can invest between 5-10% of my net worth in a stock at cost

Exposure to equities has been between 55% - 70% over past 5 years (currently at 60%), balance in fixed income MF ready to be pulled out

Selling - Sell when

- If I am convinced that risk reward is skewed against me, inverse of my buying criteria
- If the allocation to a stock is large enough to set me back by a substantial in case of a 20% fall (especially after a steep run up)
- If I believe my reading of the situation has been wrong

Yet to figure out the art of selling

Haven't been able to do an optimal job in selling Sanghvi Movers

Selling based on valuation needs to be driven off intelligent triangulation in addition to a reverse DCF mindset

Work Ethic, Temperament & Misc

"Everyone wants to be a body builder, nobody wants to lift no heavy ass weights" - Ronnie Coleman

"Everyone has a plan till I punch him in the face" - Mike Tyson

"You will never get the right answers if you keep asking the wrong questions" - Oldboy

"If you can't put up with my worst, you do not deserve my best" - Marilyn Monroe

"In theory there is no difference between theory and practice, but in practice there is" - Yogi Berra

There is no replacement for doing your own thinking and hard work

Investing is one field where every one can track what the best buy, yet very few match up to their performance. One cannot invest on borrowed conviction

Eventually the best strategy is to go in with no specific strategy (a combination of self awareness and a clam, clear mind is a prerequisite though)